



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201151026**

Release Date: 12/23/2011

Date: September 27, 2011

UIL Code: 501.32-00

501.33-00

501.36-00

501.03-05

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

Letter 4038 (CG) (11-2005)
Catalog Number 47632S

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: August 10, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

B = individual
C = individual
D = individual
E = individual
F = individual
G = individual
H = business
J = individual
K = individual
L = business plan
M = business
N = business
P = state
Q = state
R = business
s = dollar amount
t = dollar amount
u = dollar amount
v = dollar amount
w = dollar amount
x = date
y = date
z = date

UIL #s:

501.03.05
501.32.00
501.33.00
501.36.00

Dear

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

ISSUE

- a. Are you formed to obtain grants primarily benefitting B and C through M? Yes, for the reasons given below.
- b. Will you operate in a commercial, non-exempt manner? Yes, for the reasons given below.
- c. Will your activities serve substantial non-exempt purposes contrary to Section 501(c)(3) of the Code? Yes, for the reasons stated below.

FACTS

B and C, owners/founders of M and N, were approached by J about opportunities to pursue grants. J works for H, a professional grant writing company based in P.

M, a for profit business, is a mobile home park/community that operates on land owned by B and C. M is also managed/operated by B and C. R was created with the intention of learning the construction business so property of M could be further developed. R later became N. B engaged in land reclamation activities such as the planning and design of land parcels, clearing, grading, hauling, water and sewer construction, and road construction. B owned and operated excavators, back hoes, bull dozers and dump trucks. These experiences gave B the background he needed to begin company M in 2000 as well as offered opportunities for B to gain insight into working with the public. N completed much of the infrastructure work for M, although the building of the water and sewer pump station and asphalt paving were subcontracted.

J informed B and C that H could provide specialized services focused primarily on, but not limited to, the grant writing process. As a result, beginning on date y, H contracted with B and C through M to perform the following:

Professional Business Services

- 1. Executive summary
- 2. Company structure
- 3. Product and service description
- 4. Marketing plan
- 5. Three year financial projections

Grant Writing Services

1. Foundation research
2. Letter writing
3. Grant application preparation and packaging
4. Grant writing
5. Consulting clients on best avenue to reach grant funding goals

As part of the grant writing process H has promised over \$ would be secured and paid to either you or M. B and C have paid H over \$ to date for all contracted services.

As part of this process for obtaining grants B and C were instructed by H to form a non-profit entity and file Form 1023 for exemption. Another contract was created for H to aid in this service. A Charter with filed Articles, a corporate minute book with Bylaws, sample minutes, a corporate seal and customized stock certificates would be received. Under the guidance of H, on date x, you were incorporated in the state of P and Form 1023 was submitted on date z.

B also investigated what section 501(c)(3) required and discussed his findings with K, a Senior Case Manager with H. B could reach the goals of providing affordable housing, preserving natural environments, and offering educational opportunities related to the housing and environmental aspects through your organization. B stated these goals seemed to be a natural fit for section 501(c)(3) when B looked at Part III section 1 of Form 1023 which states, "Section 501(c)(3) requires that organization's documents list their exempt purpose(s), such as charitable, religious, educational and/or scientific purposes". B stated that at least three of the purposes would fit your activities.

When asked why you applied for exemption, you stated that B was pursuing small business grants for B's for-profit company M, when you were contacted about H's grant services. B first conducted research on H (found them in good standing) and then proceeded to sign contracts with H for grant writing services for B's for-profit company, M. You stated that H is acting as a conduit and/or facilitator to assist B to seek grant funding from foundations for M.

Your Articles of Incorporation list G as the registered agent and F as the incorporator. Both G and F are affiliated with H. Your Articles and Bylaws both state you are organized for exclusively 501(c)(3) purposes.

Your governing body includes B as president, D as treasurer, and E as secretary.

Your stated mission is to share the blessing of residing in the Low County of State Q so that others may have improved quality of life through affordable residences, access to natural landscapes, and opportunities that will foster growth as a family and a community. You have access to numerous leased lots on 35 acres of land where mobile homes can be

installed and offered to people whose modest incomes do not allow them to live in more affluent communities. You describe the property as having brick underpinning, paved driveways, spacious decks, and landscaped yards. Roads are paved with curbs, gutters, street lights, underground utilities, and public water and sewer are already operational. Unlike other mobile home parks in the area, this community offers large lots with mature trees in a natural setting. The web site for M also reflects similar information on the community.

Your Executive Summary states that you are a start-up nonprofit foundation that seeks to provide affordable housing and hands on vocational education experiences. You will operate in an already established for-profit mobile home community, to provide housing opportunities to persons of moderate incomes. You plan to lease or rent mobile homes and 2-bedroom energy-efficient "green" cottages. You hope to sell some of the mobile home units to interested tenants once the economy becomes profitable again. You will purchase each 1400sq. ft. mobile home for \$s and construct each 1200 sq. ft. energy efficient cottage for a cost of \$t.

You will secure leases for sixteen lots, place mobile homes on ten of them, build cottages on five, and build one office/apartment building. You state if funding is received, you will add more residences for sale or lease with a percentage of the proceeds used for charitable purposes and improving community amenities. Additionally, you want to construct a nature walk through the wetlands, a picnic area by the lake, and add playground equipment. All improvements and additions are being done on the 35 acres of land operated by M and owned by B and C.

The lots referenced in your plan are provided through a lease agreement with M, and financial resources for the homes, cottages, equipment, and employees will be provided through grant funding. Income from rentals and leases will eventually allow you to support your activities.

Your business plan has a section for 'Milestones'. Under that section the following planned implementations were included:

- Pay off mortgage on infrastructure costs
- 3-1400 sq. ft mobile homes 3-bdrm
- Purchase ½ ton long bed company truck
- Mini excavator
- Equipment trailer
- Ford E-350 15-passenger van
- Track loader
- Farm tractor
- Playground equipment
- 7 1400 sq. ft mobile home 3-bdrm

- Construct nature walk/picnic
- Construction of 5 1200 sq ft cottages
- Construct office building.

Each of these milestones had exact cost figures listed with cost projections ranging from less than \$5000 to over \$1000000 (totaling over \$2000000) that you anticipated paying through the promised funding.

Your current physical location is an office within a maintenance building of M. You explained that funding received by M would pay off the mortgage of the property owned by B and C and that you would then have a 20 year lease of that property. The rental income from this lease would then pay off additional mortgage debt incurred by M from infrastructure construction done on the surrounding properties owned by B and C. While you provided executed agreements for the use of equipment and other facilities from M, you did not provide a signed and dated copy of the rental agreement for the use of the building office. Paying down this existing infrastructure debt will entitle you access to numerous leased lots on 35 acres of land (owned by B and C) where mobile homes can be installed and offered to people whose modest incomes do not allow them to live in more affluent communities.

While you listed zero dollars in revenue and expenses on Form 1023 your business plan shows you anticipate approximately \$4000000 in revenue primarily consisting of government and private grants. Of that you project approximately \$3000000 in expenses including payroll, marketing, construction expenses, depreciation and asset purchases. Start-up expenses would include creation as a legal entity, the business plan, and pursuit of grant funds which have been paid for from B and C's personal funds. You will reimburse B and C for those expenses when grant funding is attained. The balance sheet in your business plan also shows excess funding will actually satisfy a current mortgage once grant funding is received.

B and C are the primary members of your management team. B will manage all aspects of the park, related construction tasks and responsibilities, receiving a salary in the amount of \$u. C will serve as the administrative secretary/bookkeeper, and receive a salary of \$v. The two officers, individual D (treasurer) and individual E (secretary) will also serve as consultants and receive a salary of \$w each, annually.

LAW

Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(2) of the regulations provides an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides an organization is not organized and operated exclusively for one or more exempt purposes unless it serves public rather than private interests. Thus, to meet the requirement it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes.

American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), The Court considered an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services providing advice for purchases of individual securities. The court noted that education is a broad concept, and assumed arguendo that the organization had an educational purpose. However, the totality of the organization's activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was indicative of a business. Therefore, the court held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose, and was not entitled to be regarded as exempt.

Church by Mail, Inc. v. Commissioner, T.C. Memo 1984-349, aff'd 765 F. 2d 1387 (9th Cir. 1985) Church by Mail sent out sermons in numerous mailings which required a great deal of printing services. A for-profit company, controlled by the same ministers, provided the printing and the mailing. The services were provided under two contracts. The contracts were signed by the two ministers for both the organization and the for-profit company. The organization's business comprised two-thirds of the overall business done by the for-profit company. The court determined that there was ample evidence in the record to support the finding that the organization was operated for the substantial non-exempt purpose of providing a market for the services of the for-profit company. The Court of Appeals pointed out that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise

is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church." Moreover, the ministers' dual control of both the Church and the for-profit company enables them to profit from the affiliation of the two entities through increased compensation.

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36, the Tax Court concluded that when a for-profit organization benefits substantially from the manner in which the activities of a related nonprofit organization were carried on, the latter organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if it furthers other exempt purposes.

KJ's Fund Raisers, Inc. v. Commissioner, T.C. Memo 1997-424 (1997), affirmed 82 AFTR 2d 7092 (1998) While the organization raised money for charitable purposes, it also operated for the substantial benefit of private interests. The organization's founders were the sole owners of a bar, KJ's Place. The organization sold lottery tickets exclusively at KJ's Place during regular business hours. While in KJ's Place, the lottery ticket purchasers were sold beverages. The initial directors were the two founders and a related individual. The initial board was replaced several times until the two founders were no longer on the board. At all times these two individuals were the organization's officers, salaries had been paid to them and rent had been paid to KJ's Place. The organization maintained that the fact that salaries and rent were no longer paid in this fashion indicated the independence of the board. The Court took another view: "Although those practices ceased and are not in issue here, the current board of directors is composed of at least the majority of the same members who allowed those amounts to be paid."

APPLICATION OF LAW:

You are not organized and operated exclusively for charitable, educational, or religious purposes consistent with Section 501(c)(3) of the Code nor Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations and therefore fail to meet the operational test. Specifically, you were formed for the purpose of obtaining non-profit grant funding used to make capital improvements to land owned by B and C and operated by their for-profit company, M thereby serving the private interests of B and C.

You do not meet the provisions of Section 1.501(c)(3)-1(c)(2) of the regulations as funding to your organization will be used to further the personal interests of B and C. As you have stated, funding that is secured through your organization will be used to pay off existing infrastructure debt on property owned by B and C through M as well as to make capital improvements on the same property. In addition, funding will be used to compensate B and C in reclaiming funds expensed for services provided by H. You also do not meet the provisions of Section 1.501(c)(3)-1(d)(1)(ii). As you are set up to benefit B and C directly, inurement is present, so you are also serving substantial private interests.

As seen in the Better Business Bureau ruling, the presence of any non exempt purpose, if substantial in nature, will preclude exemption. Despite your educational activities of training individuals your overall purpose is to further benefit the business of M and its founders, B and C, improving the property on which M operates as well as using your organization as a vehicle for which to obtain grant funding for M.

Consistent with the American Institute for Economic Research ruling, because your primary purpose is to construct, for sale or lease, manufactured homes on property owned by B and C, and then generate rental income through those homes, you are operating in a commercial manner indistinguishable from the activities conducted by M and N. Because you are operating for commercial purposes you do not qualify for exemption under 501(c)(3).

Similar to the organization in KJs Fund Raisers, as the same individual (B) that will have control over your operations will also be simultaneously managing M private rather than public interests are being served. The decision to use M and N's property, equipment and facilities demonstrates a lack of public oversight and/or control and limited public benefit and private interests are being served. Improvements made on site through your training programs directly benefit the owners, B and C. You are structured to allow for the flow of funds to M through any grant funding that is received. Additionally, although C is not a positioned member of your governing body, she directly benefits as well through her relationship with B.

Similar to the organization in Church by Mail, dual control exists between certain members of your board and M that enables those owners of M, your founders, to benefit from this relationship. Through your activities M will be funded through grant applications and rental income while capital improvements will be done to properties under M's control. Further, the owners of M, B and C, will be receiving salaries and rent through lease agreements for the use of those facilities for your exempt activity Like the organization in International Postgraduate Medical Foundation, M benefits substantially from your operations in the form of the receipt of public funding to expand and supplement its business purposes. Because you are formed to further private interests through your operations you do not qualify for exemption under Section 501(c)(3).

APPLICANT'S POSITION

You stated the following:

- The information submitted thus far was created a long time ago and that your activities now are educational by providing vocational training for students to receive hands-on training in the construction field.
- Your purpose is to create educational opportunities for students to participate in hands-on experiences that are related to the construction industry.

- The grant money received for the for-profit will be used to improve the mobile home community owned by for-profit company M.
- Money generated by for-profit company M through its current business operations and grant money specifically earmarked for the for-profit company M will be used to make improvements to for-profit company M, Mobile Home Community.
- The grant money received by you will be for salaries and buying equipment used for the vocational training of students.
- Payroll or salaries will be used for classroom instruction and minimal administrative costs associated with the foundation. Many hands-on activities will not improve the property on which they occur because these activities will be happening over the over again. (i.e. finding property corners, identifying setback, creating a mock site plan based on lot size, using equipment to dig and trench and then refill it). If improvements to property are made, those improvements will only occur on land that belongs to you. The long term goal is for you to secure your own facility for educational purposes.
- Everything the non-profit purchases will be owned by the non-profit.
- All assets of the foundation will remain assets of yours. You hope to purchase a 15-passenger van to transport students; it will belong to you only. You hope to purchase some equipment for training purposes; that equipment will belong to you.

SERVICE RESPONSE TO APPLICANT'S POSITION

- Your Articles of Incorporation were filed on x and your signed contracts were signed in April, May, and June of 2010, respectively. Your business plan was for the years 2010, 2011, and 2012. Your application for exemption was filed in June 2010. These recent facts contradict your assertion that the operational information you have presented thus far is obsolete.
- You indicated that your exempt purpose would be to provide educational opportunities for students in the field of home construction. While this purpose could be considered educational under Section 501(c)(3) of the Code, the construction of homes on property owned by B and C constitutes inurement to insiders which bars exemption under Section 501(c)(3) of the Code. In addition, the future rental or sale of homes is a substantial non-exempt commercial purpose contrary to Section 501 (c)(3).
- While you indicated that future grant funds received by you as well as the for-profit, M, will be kept separate, your grant funds will be used to provide for the capital improvement of land owned by B and C, who are your insiders. This circumstance qualifies as inurement to insiders and is prohibited under Section 501 (c)(3) of the Internal Revenue Code.

- Lastly, you indicate that improvements to property via the construction of homes will be made only to property you own as its your long term goal to secure your own facility. The facts, however, demonstrate that current capital improvements will be made to property owned by B and C which will be leased to you. This situation constitutes inurement of earnings and is a bar to exemption under Section 501(c)(3) of the Internal Revenue Code.

CONCLUSION

You do not meet the requirements under section 501(c)(3) because you fail the operational test. Your primary purpose is operation of a mobile home community allowing vocational students to develop and expand B and C's property. We find that you operate for non-exempt commercial purposes and for the private interests of B and C through M. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code.

Consideration was given to whether the applicant organization qualifies for exemption under other subsections of section 501(c) of the Code. However, based on the information that you have submitted, we cannot find that you are entitled to exempt status under section 501(c) of the Code because you are operating for a significant non-exempt commercial purpose and for the private interests of B and C.

Based on the above facts and law, we conclude that you do not qualify for exemption under section 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892; Exempt Organization Appeal Procedures for Unagreed Issues.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;

4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, Power of Attorney and Declaration of Representative, if you have not already done so. You can find more information about representation in Publication 947, Practice before the IRS and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosures
Publication 892